

Chapter 4

Documentary Collections

A documentary collection (D/C) is a transaction whereby the exporter entrusts the collection of payment to the exporter's bank (remitting bank), which sends documents to the importer's bank (collecting bank), along with instructions for payment. Funds are received from the importer and remitted to the exporter through the banks in exchange for those documents. D/Cs involve using a bill of exchange (commonly known as a draft) that requires the importer to pay the face amount either at sight (document against payment [D/P] or cash against documents) or on a specified future date (document against acceptance [D/A] or cash against acceptance). The collection cover letter gives instructions that specify the documents required for the delivery of the goods to the importer. Although banks do act as facilitators (agents) for their clients under collections, D/Cs offer no verification process and limited recourse in the event of non-payment. D/Cs are generally less expensive than letters of credit (LCs).

Key Points

- D/Cs are less complicated and less expensive than LCs.
- Under a D/C transaction, the importer is not obligated to pay for goods before shipment.
- If structured properly, the exporter retains control over the goods until the importer either pays the draft amount at sight or accepts the draft to incur a legal obligation to pay at a specified later date.
- Although the goods can be controlled under ocean shipments, they are more difficult to control under air and overland shipments, which allow the foreign buyer to receive the goods with or without payment unless the exporter employs agents in the importing country to take delivery until goods are paid for.
- The exporter's bank (remitting bank) and the importer's bank (collecting bank) play an essential role in D/Cs.
- Although the banks control the flow of documents, they neither verify the documents nor take any risks. They can, however, influence the mutually satisfactory settlement of a D/C transaction.

CHARACTERISTICS OF A DOCUMENTARY COLLECTION

Applicability

Recommended for use in established trade relationships, in stable export markets and for transactions involving ocean shipments

Risk

Riskier for the exporter, though D/C terms are more convenient and cheaper than an LC to the importer

Pros

- Bank assistance in obtaining payment
- The process is simple, fast, and less costly than LCs

Cons

- Banks' role is limited and they do not guarantee payment
- Banks do not verify the accuracy of the documents

When to Use Documentary Collections

With D/Cs, the exporter has little recourse against the importer in case of non-payment. Thus, D/Cs should be used only under the following conditions:

- The exporter and importer have a well-established relationship.
- The exporter is confident that the importing country is politically and economically stable.
- An open account sale is considered too risky, and an LC is unacceptable to the importer.

Typical Simplified D/C Transaction Flow

1. The exporter ships the goods to the importer and receives the documents in exchange.
2. The exporter presents the documents with instructions for obtaining payment to his bank.
3. The exporter's remitting bank sends the documents to the importer's collecting bank.
4. The collecting bank releases the documents to the importer on receipt of payment or acceptance of the draft.
5. The importer uses the documents to obtain the goods and to clear them at customs.
6. Once the collecting bank receives payment, it forwards the proceeds to the remitting bank.
7. The remitting bank then credits the exporter's account.

Documents against Payment Collection

With a D/P collection, the exporter ships the goods and then gives the documents to his bank, which will forward the documents to the importer's collecting bank, along with instructions on how to collect the money from the importer. In this arrangement, the collecting bank releases the documents to the importer only on payment for the goods. Once payment is received, the collecting bank transmits the funds to the remitting bank for payment to the exporter. Table 1 shows an overview of a D/P collection:

Table 1: Overview of a D/P collection

Time of Payment	After shipment, but before documents are released
Transfer of Goods	After payment is made at sight
Exporter Risk	If draft is unpaid, goods may need to be disposed of or may be delivered without payment if documents do not control possession

Documents against Acceptance Collection

With a D/A collection, the exporter extends credit to the importer by using a time draft. The documents are released to the importer to claim the goods upon his signed acceptance of the time draft. By accepting the draft, the importer becomes legally obligated to pay at a specific date. At maturity, the collecting bank contacts the importer for payment. Upon receipt of payment, the collecting bank transmits the funds to the remitting bank for payment to the exporter. Table 2 shows an overview of a D/A collection:

Table 2: Overview of a D/A collection

Time of Payment	On maturity of draft at a specified future date
Transfer of Goods	Before payment, but upon acceptance of draft
Exporter Risk	Has no control over goods after acceptance and may not get paid at due date